No. 18,908

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MEYER FELDMAN,

Appellant,

vs.

WILSON B. WOOD, District Director of Internal Revenue for Arizona,

Appellee.

On Appeal from the Judgment of the United States District Court for the District of Arizona

BRIEF OF APPELLEE

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BRIEF OF APPELLEE

OPINION BELOW

The Court below wrote no oinion. The findings of fact and conclusions of law of the District Court (R. 14-18)[1] are not officially reported.

[1] "R." references are to Volume I of the record on appeal.

JURISDICTION

This appeal involves federal income taxes and interest in the amount of $29,558.32 for the taxable year 1957. Taxpayer paid such tax and interest on August 5, 1961, and on August 11, 1961, filed a claim for refund with the District Director of Internal Revenue for Arizona (R. 1, 6), and on February 28, 1962, such claim was disallowed (R. 2, 6). Within the time provided by Section 6532 of the Internal Revenue Code of 1954, taxpayer brought this action in the District Court for the Distrcit of Arizona. (R. 1-5, 8.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1340. The udgment of the District Court was entered on April 11, 1963 (R. 19), and on June 10, 1963, taxpayer filed a timely notice of appeal (R. 21). Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

QUESTION PRESENTED

Whether taxpayer, whose lessee demolished improvements situated on the leased property, is entitled to deduct for the year of demolition his entire unrecovered cost basis for the improvements or whether he is required to amortize his unrecovered cost basis for the demolished improvements over the remaining term of the lease.

STATUTES INVOLVED

Internal Revenue Code of 1954:

SEC. 165. LOSSES.

(a) *General Rule.*—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

*　　*　　*

(26 U.S.C. 1958 ed., Sec. 165.)

SEC. 167. DEPRECIATION.

(a) *General Rule.*—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * *

(26 U.S.C. 1958 ed., Sec. 167.)

STATEMENT

The facts as stipulated by the parties (R. 8-13), adduced by the testimony (Tr. 1-63)[2] and exhibits[3], and as found by the District Court (R. 14-18) may be summarized as follows:

During 1950 taxpayer and his then living wife purchased improved real property in Tucson, Arizona. At the time of acquisition there was situated on the property a residential court and warehouse. (R. 8, 14.) On June 8, 1951, taxpayer entered into a five-year lease (hereinafter called the Blakely lease) of the property excluding the warehouse with M. V. and Geneva R. Blakely. Taxpayer removed the residential court in 1951 and erected a service station building, together with gas pumps, on that portion of the property adjacent to the warehouse. (R. 8, 14-15.)

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[2]"Tr." references are to the transcript of proceedings contained in Volume II of the record on appeal.

[3]On August 27, 1963, the parties stipulated pursuant to Rule 10 of the Rules of the United States Court of Appeals for the Ninth Circuit that the exhibits attached to the stipulations and introduced at trial may be referred to by the parties and considered by the Court without their being included in the printed record.

Taxpayer's wife died on July 2, 1953. The value of the property as of that date was $100,000 apportioned at $55,000 for buildings and $45,000 for land. (R. 9, 15.)[4]

On April 7, 1955, taxpayer entered into a preliminary lease of all the subject property, including the service station building and the warehouse, with Lawrence D. and Pauline Mayer, hereinafter referred to as lessees. This preliminary agreement was incorporated into a final lease agreement (hereinafter called the Mayer lease) on June 1, 1955, which was to run for 99 years from June 1, 1955. (R. 9, 15; Exs. B and C.) On April 15, 1955, taxpayer and the Blakelys amended their lease agreement of June 8, 1951, which had over a year to run on the original term plus an additional five-year option term, to provide that taxpayer could terminate the prior lease on 60 days written notice. (R. 12; Ex. R.)

The Mayer lease included the following provision (R. 15-161; Ex. C) which was inserted at the lessees' request (Tr. 30):

> 11. Lessee shall have the right to remove and demolish any or all existing improvements on the demised premises for the purpose of creating additional parking area, adding improvements, or providing ingress and egress to and from Toole Avenue, any such demolition and/or new improvement to be entirely at the expense of Lessee,***.

The Mayer lease agreement further provided for the assignment to the lessees of all taxpayer's rights under the Blakely lease. The lessees were given an option to purchase the leased property at a price of $160,000 at any time during the first five years of the lease. (Ex. C.)

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[4]Seciton 1014(a) and (b) (6) gave taxpayer a new basis for the property equal to its fair market value on the date of his wife's death.

In 1960 lessees exercised their option to purchase the property at $160,000. On June 30, 1960, the lease was terminated and a Bargain and Sale Deed was executed. (Deft. Ex. A; see Tr. 61-62.)

In 1957, the year of demolition, the demolished buildings had a remaining useful life of 20-25 years (Tr. 33, 37), and they had an unrecovered cost basis in the amount of $47,300[5] (R. 9, 16-17). In his 1957 income tax return taxpayer included the full unrecovered cost basis—$47,300—in his "Schedule of Depreciation" as a "Building Torn Down—and Abandoned." (R. 8, 16; Ex. A.)[6] The Commissioner disallowed the deduction in the full amount of the unrecovered cost basis but allowed taxpayer an amortization deduction in 1957 in the amount of $485.13, computed by dividing taxpayer's remaining basis in the demolished buildings, $47,300, by 97½, the number of years remaining under the lease at the time of demolition. (R. 16-17) Accordingly the Commissioner assessed an income tax deficiency for 1957 in the amount of $29,558.32 ($24,696.93 tax plus $4,861.39 interest). This action was commenced after taxpayer filed a claim for refund and the claim had been subsequently disallowed. (R. 1-2, 6, 17.)

SUMMARY OF ARGUMENT

A lessor does not incur an economic loss when a lessee demolishes improvements situated upon the leased property. This is because the lessor's rights under the lease are in no

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[5]Taxpayer's deduction on his 1957 income tax return stated an unrecovered cost basis in the amount of $48,000. This amount was subsequently adjusted to take into account $1,100 of allowable but unclaimed depreciation. (R. 9, 17.)

[6]When in 1960 lessees exercised their option to purchase, taxpayer, in reporting his gain on sale in his federal income tax return, included the $47,300 in basis at that time. (Deft. Ex. A.)

way affected by the demolition. He continues to receive the exact same rentals. Therefore the lessor is not entitled to a deduction under Section 165(a) which requires that a loss actually be sustained. The lessor's unrecovered cost basis in the demolished improvements is considered to be a cost of acquiring a new asset—a lease, whose term exceeds the remaining useful life of the buildings situated on the property when the lease was entered into. Therefore, the unrecovered cost basis must be amortized over the remaining useful life of the lease.

The demolition does not constitute the "abandonment" of "an asset" by "abnormal retirement" within the meaning of Treasury Regulations on Income Tax (1954 Code), Section 1.167(a)-8(a); therefore the lessor is not entitled to a depreciation deduction. Rather the long-term lease is considered to have been received by the lessor in exchange for his having given up the right to the use of the buildings, which were demolished.

ARGUMENT

WHERE TAXPAYER'S LESSEE DEMOLISHED IMPROVEMENTS SITUATED ON THE LEASED PROPERTY, TAXPAYR'S UNRECOVERED COST BASIS IN THE IMPROVEMENTS IS TREATED AS A COST OF ACQUIRING THE LEASE; THEREFORE, TAXPAYER MUST AMORTIZE HIS UNRECOVERED COST BASIS OVER THE REMAINING TERM OF THE LEASE.

A. *Introduction.*

The essential facts in this case are undisputed. On June 1, 1955, taxpayer, as lessor, entered into a 99-year lease (Mayer lease). Under the terms of the Mayer lease the lessee was given the right to demolish then existing improvements. At the time the Mayer lease was entered into a tenant was in possession of the premises by reason of a prior lease terminable by the will of the new lessee, who was, by the terms of the Mayer lease, entitled to the rental income from the old tenant. (R. 9, 12, 15; Exs. C, Q, R.) The record does not show when the old tenant vacated the premises, but in August 1957 the lessee demolished the old buildings, consisting of a service station building together with gas pumps and a warehouse. (R. 9, 12, 16.) The essential issue to be decided by this Court is whether taxpayer sustained a loss by reason of the lessee's demolition or whether the $47,300 unrecovered cost basis of the demolished buildings was in fact taxpayer's cost of acquiring a new asset — the Mayer lease — and therefore the $47,300 cost of the Mayer lease should be amortized over the remaining 97½-year term of the lease. (R. 16-17.)

B. *Taxpayer did not incur a deductible loss*

The narrow question under Section 165 of the Internal Revenue Code of 1954 is whether taxpayer sustained a loss. No loss was sustained in this case since taxpayer's economic position remained unchanged after the demolition. Taxpayer entered into a valuable lease June 1, 1955. Demolition of the old buildings on the leased premises, a service station building and a warehouse, occurred in August, 1957, at no expense to the taxpayer. The substance of the lease transaction ni this case was that taxpayer's reversionary interest under the Blakely lease in the service station building and his fee ownership in the warehouse was converted into a reversionary interest in both buildings, subject to the 99-year Mayer lease. See *Commissioner* v. *Moore,* 207 F. 2d 265, 272 (C.A. 9th); *Schubert* v. *Commissioner,* 286 F. 2d 573 (C. A. 4th); *Goelet* v. *United States,* 161 F. Supp. 305 (S.D. N.Y.), affirmed *per curiam,* 266 F. 2d 881 (C. A. 2d). Since the taxpayer had acquired a continuing right to rentals for 99 years he could not realize a loss as a consequence of demolition until the lease either expired or was prematurely terminated. The exercise of lessee's right to demolish the buildings did not produce an economic loss for the taxpayer since the taxpayer's economic position did not change thereby. The monthly rental did not change. The price at which the lessee's option to purchase could be exercised remained the sam.e The rights and obligations of both parties to the lease continued as if the building had not been demolished. See *Blumenfeld Enterprises, Inc.* v. *Commissioner,* 23 T.C. 665, affirmed *per curiam,* 232 F. 2d 396 (C. A. 9th), where the court said (23 T.C., p. 671):

> The term o fthe lease extended substantially beyond the remaining useful life of the building, and since the lessee's obligations under the lease were in no way curtailed upon removal of the building, we cannot conclude that petitioner in fact *sustained any loss* by reason of the demolition. (Emphasis supplied.)

Taxpayer was affected economically only when he gave the lessees the right to demolish, and this right was compensated for at the time that the lease was executed as increased rentals or other consideration. It is true that after the demolition the leased premises was without a building, but this fact did not render taxpayer's lease less valuable; rather it tended to make the lease more valuable since the lessees were in the process of putting the leased premises to a greater economic use. *Blumenfeld Enterprises, Inc.* v. *Commissioner, supra.*

Moreover, Treasury Regulations on Income Tax (1954 Code), Section 1.165-1 (b), states:

> Sec. 1.165-1 *Losses.*
>
> * * *
>
> (b) *Nature of loss allowable.* To be allowable as a deduction under Section 165 (a), a loss must be evidenced by closed and completed transactions, fixed by

identifiable events, and actually sustained during the taxable year. Only a bona fide loss is allowable. Substance and not mere form shall govern in determining a deductible loss.

* * *

(26 C.F.R., Sec. 1.165-1.)

Losses are recognized for tax purposes only when they result from a closed transaction. Here taxpayer's transaction with respect to the improvements upon the leased premises did not close upon demolition. Rather the substance of the transaction was that on June 1, 1955, taxpayer substituted a new asset — a lease — for an old asset — improvements. To allow taxpayer a deduction for his full unrecovered cost basis would distort taxpayer's income from rentals which by terms of the lease was to remain constant *ab initio.* This would be contrary to the rationale behind the annual accounting concept reflected in the statuatory scheme, which provides for annual reductions from taxable income equivalent to the costs of producing the income.

Thus, demolition, as it occurred in this case, was not an isolated act. Since the act of demolition was pursuant to lessee's right to demolish, the act of demolition should be treated as a part of the original lease tranaction. Since taxpayer's consideration received in exchange for giving lessees the right to demolish continued over the 99-year term of the lease, his cost basis in the demolished asset, which was demolished because of the lease, became a cost of receiving rentals.

The cases have adopted this interpretation. *Young* v. *Commissioner,* 59 F. 2d 691 (C. A. 9th), certiorari denied, 287 U.S. 652, treated the lessees' demolition as lessor's capital expenditure incurred in obtaining an amortizable asset. In *Young* this Court relied upon *Anahama Realty Corp.* v. *Commissioner,* 42 F. 2d 128 (C. A. 2d), certiorari denied, 282 U.S. 854, where the court said (p. 130), "The removal of the buildings was a part of the cost of acquiring the lease, * * *", and in *Smith Real Estate Co.* v. *Page,* 67 F. 2d 462 (C. A. 1st), the court said (p. 463), "* * * it would seem just and reasonable that the value of buildings removed be charged as a contribution to the cost of securing his lease, * * *". See also *Blumenfeld Enterprises, Inc.* v. *Commissioner, supra; Spinks Realty Co.* v. *Burnet,* 62 F. 2d 860 (C.A. DC.), certiorari denied, 290 U.S. 636; *Nickoll's Estate* v. *Commissioner,* 282 F. 2d 895 (C.A. 7th), affirming 32 T.C. 1346. These cases, relying on substance rather than form, viewed the lessee's right to demolish the building as part of the consideration for the rent due under the lease. Thus a landowner's use of a building was said to have been converted into a right to receive rentals. One of the costs to the lessor in obtaining the lease is his unrecovered cost basis in the building. But since the execution of the lease does not interrupt the landowner's continuing interest in the property the landowner's unrecovered cost basis is not currently deductible, but must be capitalized over the remaining term of the lease. *Young* v. *Commissioner, supra; Blumenfeld Enterprises, Inc.* v. *Commissioner, supra; Anahama Realty Corp.* v. *Commissioner, supra; Smith Real Estate Co.* v. *Page, supra; Spinks Realty Co.* v. *Burnet, supra; Nickoll's Estate* v. *Commissioner, supra.*

Thus it is clear under the statute and the cases that a lessor does not incur a loss when a lessee demolishes buildings situated on leased premises.

Taxpayer's entire argument in support of his claimed loss deduction is couched within the meaning he imparts to Treasury Regulations Section 1.165-3 (b) (2) and particularly the word "requirements." Taxpayer interprets the word "requirements" altogether too narrowly in the context of the regulation and the relevant case law.[7] The Regulations did not intend to restrict the denial of a loss deduction to situations where under the mere literal terms of the lease the lessee was obligated to demolish. In the first place the substitution of the word "requirements" for the word "terms", which appeared in the Proposed Regulations, broadened rather than narrowed the regulations. Demolition pursuant to the "terms" of a lease means literally that the lease must explicitly contemplate demolition. Since what a lease requires commonly refers to the lawful economic use of the premises, demolition pursuant to the "requirements" of a lease means that the lease must implictly contemplate demolition in order to put the premises to lawful economic use. Since under the facts and circumstances of this case, the lessee deemed the construction of a parking garage an efficient economic use of the premises and since such construction required the demolition of pre-existing improvements, taxpayer fits squarely within the regulations which denies him a loss deduction.

The second reason why taxpayer's interpretation of the word "requirements" is too narrow is that the relevant case law does not support the distinction he draws between the lessee's right to demolish and his legal obligation to demolish. It is assumed that the Commissioner intended the regulation to be interpretative of and therefore consistent with the relevant case

[7]Taxpayer relies upon correspondence between taxpayer's accountant and the Commissioner of Internal Revenue prior to the Commissioner's adoption of his final Regulations, the inadmissability into evidence of which was objected to by the Government on the grounds of incompetency and irrelevancy. Since taxpayer has not shown that this one letter written on behalf of a single taxpayer convinced the Commissioner to adopt a particular wording of the regulation for the reasons urged by taxpayer's representative, the supposition should not be drawn that a particular wording of the regulation was adopted for the *reasons* given by that one interested taxpayer representative.

law rather than to narrow the application of the case law, which would be the effect of taxpayer's interpretation.

It is clear that the cases do not distinguish between the lessee's right to demolish and his legal obligation to demolish. For example, the *Blumenfeld Enterprises, Inc.* lease, contrary to taxpayer's assertion, did not require demolition. There the lease agreement entered into October 6, 1949, contemplated that the lessee would remodel, not demolish, existing buildings. A letter agreement entered into April 24, 1950, permitted (as opposed to required) the lessee to demolish the existing buildings. The Tax Court said (23 T.C., pp. 671-672):

> To be sure, the demolition of the theatre building was not contemplated at the time of execution of the agreement of October 6, 1949, but, prior to the commencement of the lease (May 1, 1950), it had become abundantly clear that the entire purpose of the lease would be defeated unless the building were demolished. And it was in recognition of this plain fact that the *permission* to remove the building was granted on April 24, 1950. The provision granting that *permission* was a modification of the original agreement, and the lease must be regarded as founded on both the October 6, 1949 and April 24, 1950, agreements. Indeed, the razing of the building may well have constituted a benefit rather than a detriment to petitioner. The evidence suggests that the building was obsolete or obsolescent, and the rather substantial cost of demolition was borne by the lessee. Here then was a situation where such a building was removed at the expense of the lessee who was about to begin a long-term lease under terms and conditions that appear to have been highly favorable to the lessor. From the lessor's point of view the building was being replaced by an advantageous lease and therefore no deductible loss is allowable in accordance with the holdings in the

> cited cases that the unrecovered cost of the razed building is to be treated as part of the cost of the lease. (Emphasis added.)

In *Blumenfeld Enterprises, Inc.,* neither the April 24, 1950, agreement which gave the lessee the right to demolish nor the act of demolition itself affected the rentals received by taxpayer-lessor under the original lease agreement. In this case, as taxpayer stated in his brief (p. 17), "While demolition was permitted in the Mayer lease, there is no showing that it [the act of demolition] was part of the consideration or affected the rental rate". Thus, *Blumenfeld Enterprises, Inc.* is very similar to this case. In both cases the lessor's consideration received under the lease (rentals and other rights) was not affected at all by the lessee's decision to demolish or by the act of demolition. The reason for the denial of a loss deduction in each case was because lessee's right to demolish existing buildings was reflected under the lease as additional consideration to the lessor.

Furthermore in *Nickoll's Estate* v. *Commissioner, supra,* where the "* * * lease *permitted* * * * [the lessee] to make necessary alterations and additions to the building suitable to its commercial needs" (emphasis supplied) (282 F. 2d, p. 896),[8] the court did not find that the lessee was obligated to demolish in order to make additions or improvements. Thus, the court did not interpret the wording of the lease to obligate the lessee to demolish existing improvements. Rather the court said (282 F. 2d, p. 897):

[8]The Tax Court and Court of Appeals said, "Specifically, the 30-year lease agreement between taxpayers and * * * [lessee] provided that the tenant would make replacements, repairs, additions, improvements, alterations or changes necessary for its business * * *." *Nickoll's Estate* v. *Commissioner,* 282 F. 895, 896, affirming 32 T.C. 1346, 1347.

> The old building was substantially demolished as a necessary condition precedent to the execution of a remunerative lease under which taxpayers became the owner of a remodeled building. The value of the old building which was partially demolished is properly charged as a cost of acquiring valuable lease rights and is to be amortized over the life of the lease.

Nickoll's Estate was decided after the enactment of Regulations Section 1.165-3(b)(2), and the court, citing *Young,* denied the lessor a loss deduction for his unrecovered cost basis in the demolished improvements. The court's opinion quoted the regulation and stated, "Our position is consistent with a recently promulgated Treasure Regulation." (282 F. 2d, p. 897.)

C. *The taxpayer is not entitled to a depreciation deduction since the demolition of the buildings did not constitute the "abandonment" of "an asset" by "abnormal retirement"*

Taxpayer invokes Regulations Section 1.167(a)-8(a)(3) as the second of his two-pronged attack. Regulations Section 1.167(a)-8(a)(3) provides for the "recognition" of loss when a depreciable asset is "abandoned" by "abnormal retirement". The difficulty with taxpayer's argument is indicated by the wording of the subject title to Regulations, Section 1.167(a)-8(a), *Gains and losses on retirements.* Though the section provides that certain losses are recognized, it says nothing about whether a loss is allowed. Therefore it is necessary to determine whether taxpayer incurred a loss as a result of the demolition. The cases all show that demolition losses are not allowable in the year of demolition and that taxpayer's unrecovered cost basis must be amortized over the remaining term of the lease. *Young* v. *Commissioner, supra; Spinks Realty Co.* v. *Burnet, supra; Blumenfeld Enterprises, Inc.* v. *Commissioner, supra; Anahama Realty Corp.* v. *Commissioner, supra; Smith Real Es-*

tate Co. v. *Page, supra; Nickoll's Estate* v. *Commissioner, supra.* See also *Rowan* v. *Commissioner,* 22 T.C. 865, and *Schubert* v. *Commissioner,* 286 F. 2d 573 (C. A. 2d), where taxpayers properly amortized unrecovered basis over the term of the lease.

The further difficulty with taxpayer's reliance upon Regulations Section 1.167(a)-8(a)(3) is that the transaction which occurred in this case does not *in substance* constitute the "abandonment" of "an asset" by "abnormal retirement". The demolition is not a closed transaction. Rather, as the cases show, the *substance* of the transaction is that taxpayer received a valuable asset, a 99-year lease entitling him to rentals and a reversion in the buildings in exchange for relinquishing the fee ownership in the buildings. Were taxpayer to have merely demolished the buildings and not received a valuable lease by reason of such demolition, he would have been entitled to deduct his full unrecovered cost basis of the demolished buildings in the year of demolition. However, here the demolition must be viewed in the light of the surrounding circumstances, which were that taxpayer acquired a valuable lease over whose term the cost of obtaining the lease should be amortized.

It is clear that as a prerequisite to a depreciation deduction the taxpayer must own a present interest in a wasting asset. *Weiss* v. *Wiener,* 279 U.S. 333; *Helvering* v. *Lazarus & Co.,* 308 U.S. 252. As stated in *Lindheimer* v. *Illinois Tel Co.,* 292 U.S. 151, 167:

> Broadly speaking, depreciation is the loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy, and obsolescence. Annual depreciation is the loss which takes place in a year.

Or as the court said in *Schubert* v. *Commissioner, supra,* 286 F. 2d, p. 579:

> * * * before any deduction for depreciation can be allowed, the taxpayer must first establish that she has an *interest in "property"* with respect to which the allowance for depreciation is authorized by the statute. (Emphasis supplied.)

Since taxpayer had acquired a lease whose term exceeded the useful life of the building thereon, taxpayer was in no way economically affected by the demolition of the building. In *Commissioner* v. *Moore, supra,* the Court said (p. 268):

> It is not the physical property itself, nor the title thereto, which alone entitles the owner to claim depreciation. The statuatory allowance is available to him whose interest in the wasting asset is such that he would suffer an economic loss resulting from the deterioration and physical exhaustion as it takes place.

See also *Commissonier* v. *Pearson,* 188 F. 2d 72 (C. A. 5th). Taxpayer did not suffer an economic loss by reason of the demolition of the building; rather any economic loss resulted from the gradual reduction of the remaining term of the lease, and as a consequence of this loss he is entitled to amortize his unrecovered basis for the demolished building during each year of the lease.

This case is analogous to the situation where under the terms of a long-term lease the lessee undertakes to make good the physical exhaustion as it takes place. In these circumstances the lessors, notwithstanding an original capital investment and the possession of a cost basis, suffers no economic loss due to the wear and tear or decay of the property upon the leased premises and therefore is not entitled to depreciation. *Georgia Ry. & Electric Co.* v. *Commissioner,* 77 F. 2d 897 (C. A. 5th), certiorari denied, 296 U.S. 601; *Commissioner* v. *Terre Haute Elec. Co.,* 67 F. 2d 697 (C. A. 7th), certiorari denied, 292 U.S. 624. See also, Rev. Rul. 62-8, 1962-1 Cum. Bull. 31.

Taxpayer in his brief cites three cases for the proposition that demolition constitutes the type of redetermination of useful life entitling him to a depreciation deduction of the full amount of unrecovered cost basis of the demolished asset. Close reading of these cases will show that none of them support this proposition. In *Cosmopolitan Corp.* v. *Commissioner,* decided June 12, 1959 (P-H Memo T.C., par. 59, 122) (Br. 20), a lessor and its successor sought to deduct as depreciation the full unrecovered cost basis for buildings which had been demolished in order to make the property available to a lessee. The Tax Court was compelled to allow the taxpayers a depreciation deduction for the full amount of their unrecovered cost basis in the demolished building because the Commissioner had conecded this issue on brief. Even so, the Tax Court said "It is difficult to see that the preparatory steps (demolition) taken principally in the latter part of 1952 could successfully enable them to recover their entire basis in that year or the succeeding one when a few months' difference would eliminate such immediate recovery entirely." In making this statement, the court relied upon *Estate of Appleby* v. *Commissioner,* 41 B.T.A. 18, affirmed, 123 F. 2d 700 (C.A. 2d); *Berger* v. *Commissioner,* 7 T.C. 1339; *Blumenfeld Enterprises Inc.* v. *Commissioner, supra,* in concluding that if demolition had occurred in 1953 taxpayer would have been required to amortize his unrecovered cost basis rather than to deduct the full amount immediately. Thus, if the Commissioner had not conceded the depreciation issue, it is clear that the court would have denied depreciation in one taxable year and would have required amortization of the full unrecovered cost basis over the term of the lease which taxpayer subsequently entered into.

Klinck v. *Commissioner,* decided December 3, 1952 (P-H Memo T.C., par. 53,007) (Br. 20), held that depreciation deductions were excessive during two taxable years since taxpayer had received an appraisal report prepared early in the first of the two taxable years showing that the assets' useful life had been underestimated. There was no mention of demolition in that case. *Cohn* v. *United States,* 259 F. 2d 371 (C. A. 6th) (Br. 21), involved the question whether depreciation is allowable in the year of disposition of an asset if the salvage value of the asset exceeds its adjusted basis at the beginning of the year of disposition. There was no question of demolition in that case.

CONCLUSION

The appellee respectfully submits that the decision of the District Court was correct and should be affirmed.

Respectfully submitted,

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CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

Dated: .... day of April, 1964.

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Assistant United States Attorney